

Outsourcing & Privatization of Defense Infrastructure

by Paul Taibl

Executive Summary

The Department of Defense is currently undertaking a major review—the Quadrennial Defense Review—of its military strategy and force structure. This exercise may lead to significant changes in how the Pentagon organizes and prepares to fight. Left out of this equation will be how the Pentagon manages the day to day business of national defense.

This omission will be unfortunate since the need for the Defense Department to fix the way it manages its service and support infrastructure has never been more acute. While military leaders continue to downsize and reorganize the fighting force, spending on support functions and overhead costs remain stable, and, in some cases, are growing. Too much of limited defense dollars goes to support areas—the "tail. In fact, support and infrastructure now consume nearly 70% of all defense dollars, an annual sum of roughly \$160 billion per year. Such excessive overhead is inexcusable when many warfighting needs—"tooth"—remain unmet.

How can this problem be fixed? In the private sector and in state and local governments nationwide, outsourcing and privatization have emerged as management innovations that promote efficiency and improve service. Faced with a "competitiveness crisis" in the 1980s, American industry restructured and reengineered itself and is now the envy of the world. The Defense Department should try a similar approach.

Pentagon leaders recognize that privatization and outsourcing make sense. In fact they backed an aggressive outsourcing policy starting in the mid-1970s. Yet, only halting progress is being made. Moreover, areas widely touted as success stories—as BENS notes in our case studies of the defense travel system and military housing—reflect privatization in name only. Progress to date remains limited, and the projected savings exist only on paper.

A serious and effective outsourcing and privatization program requires a new mindset that cedes control and the desire to micromanage in areas not directly related to combat effectiveness. Real value to the Department's bottom line will not occur until there is "buy in" at the top of the leadership, incentives for the first-line managers to risk new outsourcing and privatization opportunities, and acceptance that, in many cases, the private sector has built a better mousetrap.

Outsourcing and Privatization of Defense Infrastructure

The U.S. private sector's restructuring experiences of the last decade yield one important lesson: concentrating on core expertise—and spinning off the rest—contributes to the bottom line. If the Pentagon's bottom line is measured by military readiness and force modernization potential, could outsourcing and privatization do for defense what reengineering and restructuring did for America's leading edge businesses?

The Business Case for Outsourcing and Privatization

The Pentagon can learn much from the experiences of IBM, AT&T, Chrysler, and others. As recently as

Report Documentation Page			Form Approved OMB No. 0704-0188		
Public reporting burden for the collection of information is estimated to average 1 hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington Headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington VA 22202-4302. Respondents should be aware that notwithstanding any other provision of law, no person shall be subject to a penalty for failing to comply with a collection of information if it does not display a currently valid OMB control number.					
1. REPORT DATE 01 MAR 1997	2. REPORT TYPE		3. DATES COVERED 00-00-1997 to 00-00-1997		
4. TITLE AND SUBTITLE Outsourcing & Privatization of Defense Infrastructure			5a. CONTRACT NUMBER		
			5b. GRANT NUMBER		
			5c. PROGRAM ELEMENT NUMBER		
6. AUTHOR(S)			5d. PROJECT NUMBER		
			5e. TASK NUMBER		
			5f. WORK UNIT NUMBER		
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) Business Executives for National Security, Washington, DC			8. PERFORMING ORGANIZATION REPORT NUMBER		
9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES)			10. SPONSOR/MONITOR'S ACRONYM(S)		
			11. SPONSOR/MONITOR'S REPORT NUMBER(S)		
12. DISTRIBUTION/AVAILABILITY STATEMENT Approved for public release; distribution unlimited					
13. SUPPLEMENTARY NOTES					
14. ABSTRACT					
15. SUBJECT TERMS					
16. SECURITY CLASSIFICATION OF:			17. LIMITATION OF ABSTRACT Same as Report (SAR)	18. NUMBER OF PAGES 25	19a. NAME OF RESPONSIBLE PERSON
a. REPORT unclassified	b. ABSTRACT unclassified	c. THIS PAGE unclassified			

five years ago, the prospects for such firms seemed dim. The popular media and business journals bemoaned the declining competitiveness of American business and pointed to the growing economic clout of Europe and Japan. But instead of the triumph of Japan, Inc., we have a revitalized and growing American business sector that is envied the world over. This transformation was painful, but it created an American private sector that is the world's most efficient and competitive.

What happened? To survive, the private sector had to merge, consolidate, restructure, reengineer, and, unfortunately, eliminate jobs. They also turned to outsourcing non-core operations in order to tap services and support from providers who were "world class" in their own fields. The short term restructuring costs and the realignment of jobs into entities of core competence were the price of future competitiveness.

Consider the Chrysler Corporation which today is the best in its class in managing its supplier chain—60,000 items from over 1,100 different suppliers. By studying and streamlining its supplier base Chrysler has trimmed its vendor pool by 36 percent in the last five years and plans to cut it another 25 percent by the turn of the century. Chrysler's best suppliers become team leaders in the design and manufacture of major automotive components. Chrysler then outsources entire processes to supplier teams. In the case of driver and passenger seats, Chrysler employees used to assemble them right on the line with components from 150 vendors. Today the company buys fully assembled seats from manufacturers like Johnson Controls, Lear, and Magna International. Overall, its "supplier cost-reduction effort" or SCORE has meant \$2.5 billion in savings for Chrysler.

Restructuring is not limited to firms making products for the commercial market only. Defense sector businesses are progressing through a similar transformation. Indeed, with defense procurement budgets rapidly declining in the early 1990s, US defense contractors have had no other option. While painful, downsizing and restructuring in defense should produce a reformed industrial sector that is both more competitive and more responsive to defense needs.

The legacy of restructuring in the private sector is today's growing US economy featuring unemployment consistently below 6 percent. Now comes the Pentagon's turn to administer the lessons of the private and defense sectors to its own restructuring.

Why Outsource—or Privatize—Some Defense Department Functions?

BENS believes that, like American business in the 1980s and the US defense industry in the 1990s, DoD should focus on "core competencies" and outsource activities not critical to its mission. For the Pentagon, its core mission is to deter threats to US national security, and, if deterrence fails, apply military force to win on the battlefield. Activities not engaged directly in this mission should be classified as non-core and should be considered for outsourcing or privatization—if such services can be provided more efficiently and effectively by the private sector.

For the Defense Department, though, there is a bureaucratic mountain to climb between decision and realization. Unlike most private sector businesses, the Pentagon does not have complete control over its structure and internal operations. It must go to Congress for permission.

Many of the Pentagon's management problems can be laid at Congress' door. For example, current law:

- requires the Pentagon to conduct exhaustive analysis before outsourcing any function performed by more than 45 DoD employees
- stipulates that the Secretary of Defense identify core logistics functions which then cannot be outsourced unless Congress is notified
- prohibits DoD from contracting out civilian guards and firefighters at most military bases
- requires a public vs. private competition before depot maintenance workload of more than \$3 million can be outsourced
- mandates that no more than 40 percent of the money allocated for depot maintenance be spent on private contractors

- prohibits outsourcing any function at the McAlester, Oklahoma, or Crane, Indiana, Army Ammunition plants, among others

Such legislation only adds to the economic inefficiencies that Congress complains plague the Pentagon. Congress should work to eliminate rather than impose artificial restrictions on DoD management flexibility. Outsourcing and privatization will do much more than improve the quality of services provided to the Defense Department. The real allure lies in the huge dollar savings that could be generated through a smart restructuring strategy. The Defense Science Board August 1996 Task Force on Outsourcing and Privatization sees the arithmetic this way:

- a. Defense Department support functions consume between \$120 and \$160 billion annually.
- b. The private sector generally records savings of between 10 and 30 percent when they outsource non-core functions.
- c. Select a middle range target of about 20 percent savings for the Pentagon, apply it to only half of the Department's support expenditures, and annual outsourcing savings on the order of \$12-16 billion could be achieved.

Aggressive outsourcing and privatization should not affect core military capability and readiness. Efforts are directed at support and infrastructure activities, not at combat or operational units. Today, many military personnel and defense civilian employees do the same work as counterparts at Sears, Federal Express, and Kaiser Permanente. In fact, the DoD payroll supports more than 640,000 workers whose jobs have equivalents in the private sector. As a stand alone company, this huge DoD workforce would rank third in total U.S. employment behind Wal-Mart and General Motors.

Consider some of the Pentagon's current "business lines." They include social services, education and training, data processing, real property maintenance, equipment maintenance, health services, base maintenance, installation services, and product manufacturing. The people performing these jobs are hard-working and dedicated. Nevertheless, their work falls far outside of DoD's "core mission." They face cumbersome government rules and regulations, and often lack effective incentives to do more with less. With few exceptions, it is unlikely these units can perform their jobs as effectively and cheaply as specialized private sector firms.

Outsourcing vs. Privatization

Popular discourse on outsourcing and privatization tends to blur the distinction between the two concepts. The terms outsourcing and privatization are often used interchangeably—and often in the same breath.

Outsourcing is contracting out for certain services and support formerly accomplished with internal resources. Governments, as well as the private sector, outsource.

Privatization goes beyond outsourcing by implying transfer of assets or ownership as well. Only governments privatize, since it implies moving public assets into the private sector. In the private sector, such transfer of assets is commonly called a "spin-off."

For this analysis, we try to use outsourcing as the process the Pentagon uses to buy services and support from the private sector; privatization as a specific solution in those cases where the Pentagon is willing to turn over ownership and management responsibility as well. Occasionally we slip and use the terms interchangeably.

The Pentagon's Record on Outsourcing and Privatization

Outsourcing government functions is not new to the Defense Department. In 1966, the Office of Management and Budget ruled (in Circular No. A-76) that the federal government ought not compete with its citizens for the right to provide services to the government. Since that time, the Pentagon has had a large

contracting-out program. Nearly every support and service function in the Department has, at one or another time, been outsourced. For example, 9 percent of health services, 12 percent of education and training, 47 percent of data processing, and fully 96 percent of base maintenance is contracted out. However, the overall process has never been managed in a systematized, comprehensive, department-wide manner.

To most business leaders, the controversy over additional DoD outsourcing and privatization is puzzling. Pentagon reluctance runs counter to the course of one of its most critical contracting out activities—the acquisition of new weapons systems. The Federal government operates very few of its own factories; however, it does support a fully-privatized system of contractors who in-turn supply the Defense Department with world class products ranging from new aircraft to next-generation computers. If the private sector can build these critical weapons systems, why not take advantage of its capabilities in more mundane activities like property management and payroll processing?

In the late 1990s, tight defense budgets are moving outsourcing and privatization from the "virtue" to the "necessity" category. "Outsourcing"—used interchangeably with "privatization"—is becoming the buzzword in most defense debates on how to do more with less. The military services recognize the potential benefits. In fact, the service budgets each contain a \$2.5-3 billion "wedge" of projected savings from a very limited menu of outsourcing proposed over the next five years.

Some key officials in the Department "get it" and are trying to learn from and duplicate private sector experience. For example, there are serious efforts underway to begin privatizing military family housing and base services. Despite these first steps, overall progress is limited. In some cases, an outdated and entrenched bureaucratic mindset blocks plans to utilize the private sector. In other cases, well-meaning efforts to learn from the best of business have been hampered by arcane and convoluted laws and regulations that restrict DoD's ability to introduce more flexible and innovative management practices. For example, federal law still requires that 60% of weapons repair and maintenance work be performed by the public sector, even if it has been demonstrated that private firms can do this work more cheaply and more efficiently.

BENS' Business Review of Defense Outsourcing and Privatization

Of the potential DoD outsourcing and privatization candidates, which should be pursued; which left alone? In 1996, BENS began a review of successful outsourcing and privatization cases—both in and out of government—that might reveal business solutions to help the Pentagon slash high overhead.

Developing a list of potential candidates is not difficult. What to outsource is widely accepted; but the "how" of outsourcing remains in short supply in the Defense Department. Our analysis focuses on how to move from public operations to private support and ownership. Through a series of case studies, we try to show where positive results might accrue from adopting a private sector approach. The first two case studies, which review current Pentagon initiatives in official travel management and military family housing, show how far the Department has come and what remains to be done.

Both case studies highlight the difficult problem of changing management culture. Many Defense Department officials view outsourcing and privatization as welcome mechanisms for bringing private sector process and practice into the Department. But they do not seriously consider the next step—that entire functions need no longer be managed and controlled by government personnel.

BENS' assessment of the Defense Department's outsourcing and privatization efforts to date reveal two major shortcomings:

1. Defense officials lack an appreciation of the relationship of time to money that drives the private sector's bottom line. Too many bureaucratic layers prevent the Department from taking advantage of the pace of business. Time is lost; money wasted

2. In many cases, the Department is not asking the right outsourcing and privatization questions. Instead of trying to emulate the best in the private sector to fix a Defense Department problem, they ought to ask why they need to be in certain businesses at all. If the private sector can do it more efficiently and cheaply, the government should consider exiting the market as an owner and returning as a world class consumer.

Real (and effective) privatization requires giving up control and the temptation to micromanage processes. It means becoming a world class consumer of best-in-class products and services. When Chrysler outsources car seat production, Chrysler workers do not produce the seats and production does not occur in company plants. The Pentagon needs to adopt a similar model. If it wants the full benefits of privatization, the Defense Department must be willing to cede ownership and control.

Risk-aversion prevents the Defense Department from the full benefit of lessons learned by private industry. Inertia hinders its laudable effort to concentrate on core competencies and spin off the rest to quality providers. Today, the projected savings from outsourcing look like paper profits only. The real value to the Department's bottom line will not occur unless and until there is "buy-in" at the top of the leadership, incentives for the first-line managers to risk new outsourcing and privatization opportunities, and acceptance that, in many cases, the private sector has built a better mousetrap.

Case Studies In this Report:

Defense Travel System

The reengineered Defense Travel System, subject of the first case, is well on its way to becoming a success story. By 1998, Pentagon travelers should have a state-of-the-art travel management system, virtually paperless and based on the best practices of the commercial travel industry. But it will still be the Pentagon's system, locked in time, while the US travel industry moves ahead. BENS recommends further reengineering:

- The Defense Department needs to emulate best private sector travel system practices and, at the same time, invest more in private sector support and services.
- The current DoD strategy, if pursued unchanged, will not take full advantage of opportunities and new processes that exist in the private sector. The goal ought to be to move the entire non-core travel function out of the Department.
- Defense Travel Region pilot projects encouraged software development and systems integration, making the Department's system work better. However, outsourcing—not reinvention—makes most sense.

Military Family Housing

BENS study of military family housing reveals a program that is at a crossroads. The Department is now determining whether to privatize its construction program or to change military housing compensation policy. The housing need—expected to cost more than \$20 billion over 30 years at current rates of investment—can only be met if the Pentagon is willing to take advantage of private sector solutions. But the Department's preferred solution of trying to fix the current housing problem by becoming—albeit with private sector help—a better landlord, is shortsighted. The Defense Department ought to question why it needs to be in the housing business at all. To succeed, we recommend a decidedly private sector approach to housing servicemembers and their families:

- Defense Department housing authorities need a broader vision. They should ask, "Who can best provide affordable housing to servicemembers and their families?" Thus far, they have only focused on fixing today's problems: renovation and replacement.

- To capitalize on best commercial practices in providing housing, the Defense Department needs to undergo a change in roles from that of builder to that of broker.
- The Department's goal ought to be for all servicemembers to view his or her housing needs from the same perspective as a civilian buyer or renter in the commercial marketplace.
- The military should move to a true "rent-based" system. Providing a housing allowance to every eligible servicemember creates "consumers" rather than tenants, and encourages accountability and responsibility.

Congress should legislate compensation plans aimed at giving people sufficient money so that all military members can afford off-base housing of adequate quality in safe neighborhoods. Compensation proposals that allow the servicemember rather than Congress to decide how much to spend on personal housing make sense.

The following case studies are the first and second in a series. Future studies will be released as completed.

TAKE A RIDE ON THE REENGINEERED DEFENSE TRAVEL SYSTEM

Even in peacetime the US Defense Department sends more people more places than any other arm of the government. With 8.2 million vouchers for official travel processed in 1993, the Defense Travel System lays claim to being the biggest in the world. Unfortunately, it might also be the least efficient and costliest. Travelers spent at least 1 hour but, more typically, 5 to 7 hours handling paperwork before and after trips, and then waited 15 days for the claim to be processed. With processing costs running 15 to 30 percent, it cost the Pentagon a billion dollars to administer its \$3.5 billion travel budget.

For a decade, chief financial officers in the private sector have reined-in the cost of business travel by automating and simplifying the rules. At General Electric Company, for example, the travel budget exceeds \$750 million a year and the travel system handles 600,000 claims annually. However, administrative costs are just 3.2 percent of direct costs and travel claims are processed for an average \$24 per claim. The US travel industry today considers processing costs of 6 percent the benchmark of an efficient operation.

By its own admission, the Pentagon entered the information age with a travel system that was a throwback to the era of carbon paper. In looking at the private sector travel industry, it sees opportunity to reengineer its own travel process from end-to-end. DoD officials predict success. By 1998, Pentagon travelers should have a state-of-the-art travel management system, virtually paperless and based on the best practices of the commercial travel industry.

But it will still be the Pentagon's system, locked in time, while the US travel industry moves ahead. To BENS, taking the next step should be the Department's objective. The Pentagon can never run its a travel process the private sector travel industry in terms of running the most efficient or effective system. The Pentagon will still be in the travel business, when it should instead be a first-class customer relying on the private sector to run its travel program.

SUMMARY OF BENS RECOMMENDATIONS

- The Defense Department needs to emulate best private sector travel system practices and, at the same time, invest more in private sector support and services.
- The current DoD strategy, if pursued unchanged, will not take full advantage of opportunities and new processes that exist in the private sector. The goal ought to be to move the entire non-core travel function out of the Department.

- Defense Travel Region pilot projects encouraged software development and systems integration, making the Department's system work better. However, outsourcing—not reinvention—makes most sense.

DEFENSE DEPARTMENT TRAVEL: RECENT HISTORY

Bringing Defense Department travel into line with the best commercial practice was the challenge Karen Cleary Alderman faced when she joined the DoD Task Force to Reengineer Travel in July of 1994.¹ After studying the system, Alderman, with co-chair Nicolai Timenes, DoD's Director of Military Personnel Policy, concluded that DoD's system was fragmented, inefficient, expensive to administer, and that it occasionally impeded rather than aided mission accomplishment.²

The hodgepodge of travel-related systems and procedures evolved over many years. Each military service had its own interpretation of the rules. With no one individual in the Department responsible for overall operation, systems multiplied and none were integrated. The Department was saddled with a large and costly administrative overhead burden which added to the real cost of doing business. In sum, the legacy was an exceptionally complex system which had defied all previous attempts to streamline it (see chart).³

Within 6 months, the task force had seen enough of the Department's systems to issue a "Red Book." It documented the need for change and provided a blueprint for reengineering DoD's travel process.⁴ Recommendations included simplifying entitlements for travelers and publishing rules in plain English, decentralizing travel budgets, and making supervisors responsible for managing travel within their organization. Contracts were recommended for full service commercial travel agencies to make all arrangements, issue travel cards to pay travel vendors, speed travel voucher settlement, and provide electronic funds transfer to speed the settlement of

claims.

Following the "Red Book" report, Ms. Alderman took charge of the Reengineering Travel Transition Office. Its purpose was to develop new policy and to coordinate the actions of the military services and Office of the Secretary of Defense. In December 1995, the Defense Travel System Project Management Office under Colonel Al Arnold, USA, was established to implement a DoD-wide solution based on recommendations of the Travel Transition Office.

BENCHMARK SOLUTIONS

The essential elements of the travel process are the same for government and private industry: authorization to travel, arrangements, payment, execution, reconciliation, and accountability.

What would a best practice travel industry process look like? Private sector travel systems promote "best in class" practices:

- **Written policy.** Published corporate guidance can be reduced to ten to fifteen guidelines that are easily read in 20 minutes.
- **Supervisor responsibility.** The immediate supervisor or manager can authorize travel, approve expenses and manage and monitor usage of travel funds.
- **Corporate credit cards.** Corporate travel cards are employed for all expenses. Automated Teller Machines (ATMs) or travelers checks are employed for cash advances.
- **Commercial Travel Offices (CTOs).** Corporations make extensive use of "full-service, one-stop shopping" for ticketing and reservations. The servicing travel agencies know corporate policy and are rewarded (or penalized) based on established performance measures. Turn-around time for services is virtually immediate.
- **Help lines.** Around-the-clock service through an 800 number is provided.

- **Automated administration.** Corporate policy is built into the software or "enablers" allowing direct expenses, parameter checks, and administrative surcharges to be calculated automatically.
- **Selective audits.** Travel vouchers are audited at random rather than exhaustively.
- **Rapid reimbursement.** Average reimbursement is two to four days with payments made through Electronic Funds Transfer (EFT).
- **Administrative costs.** Indirect costs of bill processing, travel advances, voucher processing, receivables management, float and data processing is approximately 5 to 6 percent of the direct cost of travel.

THE DEFENSE DEPARTMENT'S VISION

Dr. John Hamre, the Defense Department's Comptroller, took the private sector benchmark as his vision for a reengineered travel system. He proposed a seamless, paperless process that:

- meets the mission needs of the traveler, commanders, and other travel resource managers
- reduces the cost of travel
- provides superior customer service

His three major aims are to simplify the rules, delegate authority, and use best industry practices.⁵ Hamre wants to "ride the travel industry's bow wave of technology" even if it means waiting a little longer to complete the makeover. He also intends to measure results the same way a corporate CEO would: the reengineered travel process will be measured on achievement of performance goals rather than cost savings goals. By adopting best practices, the overarching goal is to achieve results comparable to those achieved in the private sector.⁶

FAST OUT OF THE GATE: AIR FORCE AND THE NATIONAL SECURITY AGENCY

When DoD's Task Force to Reengineer Travel got started in 1995, two independent DoD reinvention laboratory projects were already in full stride as part of Vice President Gore's National Performance Review: the National Security Agency's Travel Reengineering Project and the Air Force 11th Support Wing's Travel Reinvention Project.

NATIONAL SECURITY AGENCY

NSA had just finished an exhaustive analysis of its travel-related costs. In FY 1994, NSA incurred \$30 million in direct travel costs. They identified an additional \$8 million in indirect costs. Based on the 22,000 trips taken that year by NSA employees, the indirect administrative cost came out to \$370 per trip. Excluding the lost productivity of the traveler filling out forms and waiting in line, the administrative burden was still \$5 million—about 17 percent of direct travel cost or \$230 per trip.

However, by May of 1996, NSA had succeeded in completely revamping the agency's travel process, sharply cutting the time and cost. They also won the RIT/USA TODAY Quality Cup in the Government category. They chose best industry practices over old. Today, all NSA employees have an American Express corporate card for expenses and cash advances. In fact, American Express handles all of NSA's travel planning. Only one manager must approve travel—down from five. The travel and expense form has been reduced to one page, and a paperless process is on the way.

In all, total travel processing time has dropped from 79 days to 6 days. Employees are reimbursed in under 36 hours instead of nearly 2 months. Already the annual travel surcharge has been cut by \$2.5 million. The final cost target: \$2 million a year.

AIR FORCE

In 1993, the 11th Wing at Bolling AFB, DC, developed the Federal Automated System for Travel (FASTravel). To date, it is the only paperless system in the Defense Department. Having overcome initial problems with connectivity and the need to upgrade Local Area Net (LANS) to enable data interchange, the FASTravel system is providing, end-to-end travel services to personnel at Bolling AFB, Headquarters Air Force and the Joint Chiefs of Staff in the Pentagon, and to the Air Combat Command at Langley AFB, Virginia.

TRAVEL REENGINEERING PILOT TEST SITES

Following the report of the Reengineering Travel Task Force, the Defense Department authorized a pilot testing process designed to baseline the current system in an operational environment and to try out some of the travel improvements that were already being used by a few defense agencies and the military services.

DoD travel operations are truly global, serving 3.4 million potential travelers. The Department has a base structure of 565 installations in 50 states, 2 U.S. territories and in 19 overseas locations. For management necessity, the Defense Travel System is subdivided into 12 Defense Travel Regions (DTRs), nine in the U.S. and 3 overseas.

The Department created a pilot testing process at 27 different sites scattered across the DTRs representing each of the Services and several Defense Agencies (there are 7 Army, 5 Navy, 2 Marine Corps, and 5 Air Force pilot test organizations). The Joint Staff, National Security Agency, Defense Commissary Agency, DFAS, Defense Logistics Agency, Defense Mapping Agency, and Defense Nuclear Agency and Washington Headquarters Services are also participating in the test.⁷

The concept of operations laid out for the test sites built on 10 guiding principles and the three objectives of the travel reengineering effort: simplify the rules, delegate authority, and use best industry practices.

By the end of 1995, the sites were testing various procedural changes, such as the delegation of travel approval authority, reimbursement via electronic fund transfers, and random audit of vouchers. There were five major commercial computation software programs being used and seven on-contract commercial vendors supporting the travel arrangements phase of the test.⁸

The pilot process has made early progress. First, the complex body of regulations has been reduced to 17 pages of plain English. Numerous simplifications in the allowance system have been implemented. A flat 75 percent of the daily per diem rate for meals and incidental expenses is paid on the first and last day of travel—much simplifying the computation process. Receipts are no longer required for expenses under \$75 except for lodging. The requirement to obtain paper statements when government-provided meals and lodging are not available has been eliminated. Finally, in probably the biggest change, all travel reimbursements and payments are now made by electronic funds transfer.

Baselining the current travel system at the 27 test locations has taken longer than planned. Results were to have been complete by July 1996. Test operations have since been extended to March 1997. Nevertheless, plans continue for issuing a formal request for proposal (RFP) in early 1997 for commercial travel services and support for Defense Travel Region 6 (eleven midwestern states).

TEN PRINCIPLES GUIDE THE TRANSITION OF THE DEFENSE TRAVEL SYSTEM:

1. Travelers and supervisors are honest and responsible.
2. Allow the supervisor to control his or her travel budget and approve vouchers.

3. Implement simple clear rules to govern travel.
4. Rely on one-stop shopping at a commercial travel office.
5. Consolidate the process into a single piece of paper.
6. Eliminate bureaucratic burdens on travelers.
7. Ensure prompt payment by government.
8. Minimize bookkeeping requirements.
9. Use best industry financial practices.
10. Continuously reassess for improvements.

TRAVEL REENGINEERING CHALLENGES

The Defense Department's travel system overhaul is progressing, but challenges remain. Known problems range from technological to cultural and statutory.

The technological challenges, while time consuming to fix, are probably the easiest of the implementation problems to overcome. They include:

- **Software solutions.** Early in development, the commercial software products proved generally inadequate, lacking internal controls for DoD travel-related policies and missing official mileage tables. Software upgrades have been made, but the process has been lengthy.
- **Electronic signature.** Verifying the traveler's authorization in an electronic medium must be simple yet secure. Its solution is a government-wide problem because federal law—in the False Claims Act—establishes stringent requirements for disbursement of federal funds. The US General Accounting Office is ultimately responsible for developing the electronic signature process but has granted the Air Force a waiver to test its FASTravel system solution. At the same time, the Travel Transition Reengineering Team is working on a verification scheme that can be employed using software rather than having to hardwire specific electronic components into pieces of the verification system.
- **Receipt retention.** The government wants to end warehousing millions of travel receipts. Working with the IRS, the policy has already been changed to raise the receipt retention threshold to \$75 (except for lodging and transportation). But the remaining question is: who is required to retain the receipt, the traveler or DoD?
- **Split disbursement.** Verifiable and accountable procedures must be designed so payments of a single voucher can go to different creditors, including the traveler. Today, it is the traveler's responsibility to make final payments from a single government disbursement. Resolution could lead to third party payments which could get the government out of the disbursement process entirely.
- **Electronic commerce.** The travel industry is constantly updating its computer hardware and software, the Defense Department has to come up with acquisition procedures that will allow it to keep pace.
- **Rate concurrency.** Entitlement rules, fare prices, and other rates change frequently. Insuring that arrangements, estimates and claims are made with the latest, accurate data is crucial to system confidence and integrity.
- **Validation of software enablers.** In addition to the main software drivers of the travel system (the two main programs are Travel Manager and the Air Force-developed FASTravel system) numerous software enablers were developed to connect separate systems and hardware at the test sites and between test sites and DFAS. These pieces of software will continue to be validated throughout the pilot test period and will undoubtedly require further management and refinement throughout their useful life.
- **Standard accounting record.** The travel voucher—which provides the record of cost and reimbursement for traveler and accountant—has been shortened and simplified. Most Army travelers started to receive the new form in August 1996. The new voucher doesn't change the type or form of information the traveler needs to submit—those changes are more than a year away—but it does simplify what they get in return.

Connectivity. Getting various computer platforms, local networks and data interchange systems to connect seamlessly is a major problem. Restricted access accounting systems and network configurations controlled by systems' administrators are easiest to connect. But giving travelers access to these systems from their desktops, as the proposed plan envisions, is hard because of the many different models and capabilities in DoD offices—each with slightly different performance characteristics. DoD should rely on standard electronic commerce/electronic data interface protocols because information infrastructure varies across organizations—even at the same installation.

Another set of problems are systemic and cultural.

Changing the status quo and the habits of travel administrators and travelers will require effort and the full commitment of the Defense Department leaders. Challenges include:

- **Reducing rules and regulations.** Cutting the Federal Travel Regulations from 230 to 17 pages permitted the Department to claim that it was in line with commercial best practice. However, while adequate for the traveler to understand the system and his or her responsibilities, administrator and travel managers have complained that the re-write lacks sufficient detail for them to carry out their responsibilities.
- **Use of travel cards.** More than any other part of the reengineered system, the DoD travel card has a potential to cause problems. Use of the card is key to getting the government out from under the internal overhead needed to provide cash advances to travelers. Cards can also ease the traveler's business transactions while on the road. Implementing the card—over 850,000 have been issued to DoD personnel—is a cultural change to travelers accustomed to using cash.⁹
- **Regional solutions.** In December 1995 a draft statement of work for the Defense Travel System was released to industry for comment. The draft stipulates a comprehensive official travel service contract that will replace the current CTO contracts now in place. The solicitation requires the winning contractor to employ best industry solutions to all phases of the travel process. Good up to this point. But the contracting strategy behind the solicitation is to award a single contract to a single Defense Travel Region. In fact, a formal Request For Proposal (RFP) for DTR 6 is expected sometime in November 1996.

Such a contracting strategy has two weaknesses. First, it allows, perhaps encourages, the 11 remaining travel regions to evaluate and select from different travel industry vendors. Competition is desirable, but there is a great risk that eventually the DTS will reflect the differences in contractor approach. DoD ends up having to maintain internal consistency and configuration control, in addition to managing multiple contracts. Awarding the entire DTS to a single contractor may not be the better solution, but a "systems" approach might lead to selecting a private sector systems integration company to operate the entire DTS—including selection of CTOs—for DoD.

The second weakness is that the contract for DTR 6 is probably a year away from completion—followed then by a lengthy implementation period. The other regions are still "contract lead time away" from getting their reengineered travel systems up and running. Such delays are not necessary. The Travel Transition Office has identified the attributes that DoD wants in its reengineered DTS. The private sector has already put such travel improvements into practice. A great deal of time could be saved if DoD were to simply turn to the private sector to accomplish its reengineering effort.

- **Individual user familiarity.** A major goal of the reengineered DTS is full automation of the system. It envisions a traveler walking up to a computer terminal and having the full capabilities of the reengineered DTS immediately available. Such a goal is possible, but not realistic. Many DoD personnel are sophisticated and frequent travelers. Full automation would be a real time-saver for them. But many personnel travel infrequently. In addition, hundreds of thousands of personnel enter and leave the Department's employment rolls each year. The cost-benefit of individual training and currency to use the automated system instead of assigning a travel specialist to unit level (unit orderly rooms) has not been worked through.
 - With each DTR possibly pursuing its own vendor and software selection, travelers being

reassigned to another to a unit in another travel region will need to learn a different process—not much of an improvement over current conditions.

- **Changing the "oversight" mentality.** Best practice in industry does not require completely fool-proof control and supervision. To do so would be too costly. However, the special considerations given to the oversight of public funds require a system which has the confidence of the Department, the Congress, and the taxpayer.
- **Continual need to train new users.** If systems vary between Defense Travel Regions as can currently occur, a need to provide training to users moving from region to region will persist. Some of this training can be done on-line, but a residual requirement is likely to remain for knowledgeable individuals and back-up documentation to be available throughout the system. A related requirement is providing support to the infrequent or occasional traveler. Some military personnel and many DoD civilians do not travel very often. It is just not realistic to expect that everyone will maintain a high level of proficiency using the automated system.
- **Evolving commercial industry practices.** In addition to an evolving electronic commerce environment and, perhaps, because of it the travel industry is changing rapidly. One area of great change is in the commission structure: this will change both DoD's costs and its access to commercial vendors.

The final set of problems will require Congressional action to resolve. Statutes governing federal travel are broad authorizations that generally would not impede DoD efforts to adopt management practices similar to those of private industry.¹⁰ However, in some specific instances, statutory changes may be necessary:

THE BUSINESS OUTLOOK FOR DoD TRAVEL

By the end of 1997, regional Defense Travel System contracts are planned to be in effect system-wide. The fully reengineered system, according to the transition team, is on track for 1998.

What will the Department have as a result? The reengineered DTS will meet operational mission requirements, improve customer service and reduce cost to the government—all entering goals for the effort. But many fear that the proposed solutions merely replace an old, labor intensive system with a streamlined, automated but nonetheless rigid new system.

The release of the first RFP opens a wide range of potential outsourcing opportunities. Not known is the degree of private sector service and support that will be sought by the Department. Safe to say is that certain functions currently outsourced will continue. For example, government travel cards (currently the American Express Corporate Card) will have expanded use. Commercial Travel Offices (CTOs) will continue one-stop reservations services. For private firms, maintaining the "enabler" software and other software development opportunities are also likely.

Other openings for the private sector to provide support and services should develop as the Department settles on the final design of its end-to-end system. For example, third party payment—a concept already being planned into the system—will open opportunities for vendors to take over part of the payment process from the government.

In evaluating the Reengineering Travel Task Force, its chief, Karen Alderman, remarked that having benchmarked DoD against the best industry practices, there was no reason for DoD not to outsource all travel-related functions save travel approval and authorization of expenses. Such a vision, if enacted over the next five years, would open tremendous opportunities for the private sector to "operate" the Defense Travel System. Since the travel industry will be, by then, almost totally automated, private sector opportunities should emerge in electronic order processing, cost estimating, voucher processing, automatic travel reconciliation, random auditing and electronic archiving. Industry should also expect opportunities to continue to provide software support, systems upgrade, and training.

BENS' ASSESSMENT

In time, the defense travel reengineering effort will turn out a government success story. However, the current slate of reforms are too conservative to take advantage of the dynamism of the commercial travel industry, which is itself in constant technological and process change.

To get a truly reengineered system, the Defense Department needs to emulate best private sector travel system practices and, at the same time, invest more in private sector support and services. To date, DoD and the travel industry have exchanged information, but they have not done business. In the pilot projects some software development and systems integration work has been completed. However, outsourcing—not reinvention—makes most sense.

In principle, the Travel Transition Office concluded that DoD could outsource all functions except travel authorization and payment approval. In practice, the DTS must adapt to data and information systems managed by the Defense Information Systems Agency (DISA) and payment and accounting systems operated by the Defense Finance and Accounting Service (DFAS). Procurement and management of the CTO contracts is done by the Military Traffic Management Command.

The current DoD strategy, if pursued unchanged, will not take full advantage of opportunities and new processes that exist in the private sector. BENS thinks the Department can eventually do more. The goal ought to be to move the entire non-core travel function out of the Department. It's the only way of tying Defense travel irrevocably to the competitive process change of the private sector travel industry.

NOTES 1 In September 1993, Vice President Al Gore's National Performance Review called for the overhaul of the entire DoD travel system. In December, DoD officials with shared responsibilities for the travel system (The Undersecretaries of Defense for Acquisition & Technology, Comptroller, Personnel & Readiness and the Director of Administration and Management) established the DoD Task Force to Reengineer Travel.

2 The travel managers' unwritten manifesto seemed to operate by a set of assumptions only a bureaucracy could conjure:

- We trust neither the traveler nor the traveler's chain of command;
- Since outsiders view travel as a luxury and not mission essential, so do we;
- If enough system regulations, controls and checkpoints are put in place, we can stop fraud, waste and abuse;
- Administrative controls and processes are "free" since they can't be measured;
- The appearance of precision gives the appearance of control; and,

Compliance with procedures is our mission, even if it impedes completion of the traveler's mission.

3 The physical dimensions were enormous: 700 voucher-processing centers, multiple travel agencies and more than 1,300 regulations. Published travel policy ran to 230 pages of Joint Travel Regulations, and the military service's supplementing policies added hundreds more pages. The travel authorization and expense reporting process had more than 17 steps, the traveler could avail themselves of multiple ticket and travel planning operations—some commercial, some DoD-managed. While en route, if the traveler needed information or clarification, there was no emergency hotline. Corporate cards provided only 16 percent of the "cash out" needs for the DoD traveler. When travel was complete, reimbursement for incurred expenses took up to 15 days. Processing costs were found to be at least 15 percent of direct costs and the task force speculated that 30% of the direct travel cost was a more likely figure.

4 In 1993, the timeframe closest to when the task force survey was done, DoD processed about 8.2 million vouchers (known as Temporary Duty or TDY vouchers to the military). Direct costs for these temporary

duty trips were estimated to be \$3.5 billion after backing out travel associated with military and civilian Permanent Change of Station (PCS) moves. Indirect costs were unquantifiable using existing accounting systems. Such costs were frequently hidden in military personnel accounts and O&M accounts. Estimable parts of the process amounted to an additional \$500 million for FY 1993, including such items as:

- Order writing process costs of at least \$300 million annually. (Estimate based on a study that identified the Air Force travel order process cost at about \$35 per order.)
- Airline ticket payment and reconciliation process costs of about \$60 million, based on a \$29 administrative charge per ticket, and with an estimated 2.1 million airline tickets in FY 1993 for TDY travel out of the total 2.8 million tickets issued.
- Voucher payment process costs of about \$100 million in FY 1993, based on a cost of \$11.28 per travel voucher as processed by the Defense Finance and Accounting Service (DFAS).
- An additional \$600,000 was spent to resolve cross-disbursing/unmatched disbursement associated with travel. In FY 1993, there were about 250,000 cross/unmatched disbursements associated with travel vouchers involving \$190 million in direct costs.
- Additional costs associated with arrangements, advances, and other parts of process as well as training of military and civilian personnel who operate and support the system.

Cost of lost productivity is not visible or calculated anywhere but, according to the task force survey, is cited as burdensome everywhere. Limited data indicates that personnel spent at least one hour (at best site), but more typically 5 1/2 to 7 hours preparing paperwork and getting through the voucher preparation process for each TDY trip. The manpower impact of 6 hours personal processing time per TDY trip versus 1 hour is about 20,000 man-years in lost productivity or training time.

5 A best practice reengineered DoD travel system would, according to Hamre's vision:

- simplify published travel policy;
- reduce the authorization/expense reporting steps;
- employ commercial travel offices and services for one-stop ticketing and travel arrangement;
- provide 24-hour "help" lines;
- use a corporate charge card for 100 percent of travel-related expense;
- reduce audit requirements from 100 percent to random;
- provide traveler reimbursement within 2-5 days; and, cut administrative processing costs to 5-6 percent of travel costs.

6 In government, no one acts alone. Hamre's vision, and, hence, Alderman's and Arnold's task, also has an organizational dimension. In corporate-speak these are the "process owners" and "stakeholders"; in the federal government, it is the bureaucracy. The Under Secretary of Defense (Comptroller) has overall responsibility for reengineering the travel process. His agent is the Reengineering Travel Transition Office. However, the Under Secretaries for Acquisition and Technology and Personnel & Readiness and the Pentagon's Director of Administration and Management also have major responsibilities.

- USD(A&T) is responsible for commercial and government transportation policy; policies on booking arrangements through a travel office (contract and organic), and policies on use of Government facilities (lodging and dining facilities) when performing TDY travel.
- USD (comptroller) is responsible for policies on payment for authorized travel expenses incurred in connection with TDY travel, to include policies on issuance and use of the government-sponsored, contractor-issued travel (charge) card, advances to travelers to pay for authorized travel expenses; and reimbursement to travelers.
- USD (P&R) is responsible for TDY travel entitlements.

There is a distinction between policy development organizations and policy execution, as well. The Project Manager, Defense Travel System, has responsibility for contracting with private vendors for travel services and support. The Military Traffic Management Command—one of the major Defense Agencies—is designated the single manager for DoD travel. The Defense Finance and Accounting Service (DFAS) and

the Defense Information Systems Agency (DISA) are also prominent players. DFAS makes the final disbursements and DISA provides the information systems on which the data is transmitted. At the next echelon are the military services themselves—from headquarters down to the base level—which set both policy and operate the system for the individual traveler. Too numerous to list, they are best described functionally as those organizations dealing directly with transportation, lodging and dining facilities. Outside of DoD, other federal agencies share in the process. The Department of State, the General Services Administration, General Accounting Office, Office of Management and Budget, and the Internal Revenue Service are involved in the process of change, since many DoD travel policies are directly governed by rules established by these agencies.

- The IRS mandates record keeping requirements. It recently approved a new receipt threshold of \$75, up from \$25.
- The Joint Federal Travel Regulation (JFTR) and Joint Travel Regulation (JTR) prescribe per diem, travel and transportation allowances applicable respectively to servicemembers and DoD civilian employees. Into the JFTR and JTR flow statutes, DoD and non-DoD policy, operational requirements, Service-unique requirements, and per diem rates set by two outside agencies (the GSA sets the rates for locations within the continental USA and the State Department sets rates for overseas locations) and the rates set by Per Diem, Travel and Transportation Allowance Committee (PDTATAC) for non-foreign areas outside CONUS. From these regulations flow numerous Service and installation-unique implementation policies, regulations, and instructions.

Other claimants, inside and outside government, impinge on change too. The government-wide Joint Financial Management Improvement Program (JFMIP) is crucial to the travel regulation process. And national government employee's unions are interested in maintaining equity between civilian and military travelers.

Congress too, is interested. In their FY 1996 Defense Authorization Act, they instructed the Secretary of Defense to test and implement a program based on the recommendation of the task force on travel management established by the secretary in July 1994; to apply that travel process throughout the department; and to provide opportunities for private sector sources to provide travel reservation services and credit card services to facilitate that travel process.

7 In March 1996, Dr. Hamre reported that the costs for the 27 pilot organizations to fully implement and test the reengineered TDY travel were estimated at \$4.1 million. This estimate includes the costs to acquire hardware and software, and to train approximately 32,000 travelers and users served by the pilot test organization.

8 In June and September of 1995, and again in January of 1996, DoD brought all the test managers and teams together to compare notes. The key in-progress finding? That neither the government nor the private sector yet had all the answers, procedures or information systems to string together an end-to-end process.

9 Major problems have not occurred due to abuse but rather from delinquency on accounts. The Air Force chose to delay trying to make maximum use of the card due to high delinquency rates at its pilot test locations. DoD has put emphasis on travel card management: establishing a \$600 limit on monthly cash withdrawals, monitoring purchases, blocking 1-900 number/catalog purchases, and, establishing a chain training program to emphasize traveler, commander and supervisor responsibility.

10 The Defense Department uses the Federal Travel Regulations issued by the General Services Administration as a basis for developing and issuing its Joint Travel Regulation, Volume 2, for civilian employee travel, while its travel policies for military personnel are found in the Joint Federal Travel Regulations, Volume 1, which the Department issues.

MILITARY HOUSING: IT'S MOVING SLOWLY INTO THE PRIVATE SECTOR

To the Defense Department, decent and affordable housing is central to improving quality of life for America's military servicemembers and their families. As part of its commitment, the Pentagon has set an ambitious 10-year goal for correcting a self-professed \$20 billion problem. Meeting the challenge means

that the Defense Department cannot afford a business as usual approach. It is seeking private capital to leverage government dollars, and also scouting ideas for building and renovating military housing faster, at lower cost to the taxpayer, and within an affordability range in reach of military servicemembers.

Is the Defense Department on course toward solving its housing problems? In 1994, BENS began tracking Pentagon housing initiatives. We met with military service housing officials and the newly formed Housing Revitalization Support Office. Throughout much of 1996, BENS members and staff participated in an informal Navy task force on military housing issues. What follows is BENS' survey of what is working—and what is not—in DoD's housing renewal effort.

BENS found progress being made—but at a rate which will likely fail to meet the 10 year goal. Yet, in America today, the private sector housing industry appears able to provide suitable housing to military servicemembers—at half of what the government now spends. The need can be met if the Pentagon is willing to take advantage of private sector solutions. But, we noted a myopic vision that seeks to fix the current housing problem by becoming—albeit with private sector help—a better landlord, rather than questioning why the Defense Department needs to be in the housing business at all. To succeed, the Defense Department needs to abandon efforts to "fix" its current system and, instead, adopt a decidedly private sector approach to housing servicemembers and their families.

SUMMARY OF BENS RECOMMENDATIONS

- Defense Department housing authorities need a broader vision. They should ask, "Who can best provide affordable housing to servicemembers and their families?" Thus far, they have only focused on fixing today's problems: renovation and replacement.
- To capitalize on best commercial practices in providing housing, the Defense Department needs to undergo a change in roles from that of builder to that of broker.
- The Department's goal ought to be for all servicemembers to view his or her housing needs from the same perspective as a civilian buyer or renter in the commercial marketplace.
- The military should move to a true "rent-based" system. Providing a housing allowance to every eligible servicemember creates "consumers" rather than tenants, and encourages accountability and responsibility.
- Congress should legislate compensation plans aimed at giving people sufficient money so that all military members can afford off-base housing of adequate quality in safe neighborhoods. Compensation proposals that allow the servicemember rather than Congress to decide how much to spend on personal housing make sense.

MILITARY HOUSING: THE RELEVANT FACTS

Historically, the military has tried to solve its housing challenge in two ways: by paying housing allowances to servicemembers who then seek housing "on the economy" (Fig. 1); and, by building or leasing bachelor and family housing on military bases which it then provides "free" to servicemembers (Fig. 2). Each method has, over time, created strong constituencies in the individual services, private industry and the US Congress (Fig. 3) which have made change difficult.

The Pentagon's relies first on the private sector to provide suitable family housing. For the private sector, housing the nation's servicemembers and their families is big business. Over 600,000 military families—about 65 percent of all military members and their dependents—live in private sector housing. They receive nearly \$4.2 billion in government-paid housing allowances which, according to survey data, covers only 80 percent of their housing costs. If out-of-pocket costs are added, over \$5 billion in rents and mortgage payments flow from military members to the US housing industry.

The government is also a major landlord. The Defense Department owns or leases, on- and off-base, about 387,000 units of family housing. In addition, 450,000 single and unaccompanied servicemembers (82 percent) live in government-owned, on-base housing (or barracks). Servicemembers living in government quarters forfeit housing allowances; the Department shoulders the expense of construction, maintenance, repair and utilities. As an example, in FY 1996 the appropriation (for family housing only) was \$4.2 billion. In FY 1997, the figure for housing construction and renovation alone is \$1.7 billion.

THE MILITARY HOUSING CHALLENGE

Quality of life is especially critical in today's all volunteer military force. In contrast to the draft era, people join the services for a career—not just a tour of duty. The armed forces today consist primarily of married members with families (61 percent compared to 42 percent in 1955). More spouses are employed (about 65 percent) and single parents (both men and women) are more common (5.7 percent of Army personnel; 4.3 percent of Marines). Today's servicemember also spends considerably more time away from home than his or her predecessor. These demographic factors place special demands on the housing system and associated support such as schools, recreation, day care—demands that are becoming harder to meet with shrinking defense resources.

The unmarried enlisted member currently has little choice in housing. With few exceptions, they must live in barracks on military bases. Married servicemembers have a choice, yet many put their names on long waiting lists—39,000 in the Air Force alone—to live in on-base houses even though they are in dilapidated condition. A primary reason is the "rent-free" aspect of base quarters. Another is security. Due to frequent deployments, living in a community with other military members, as well as having access to a nearby hospital and commissary, are considered major quality of life benefits.

Figure 1. HOUSING ALLOWANCES: BAQ AND VHA

Servicemembers living in the private sector receive two forms of non-taxed housing benefits. The primary subsidy is a basic allowance for quarters (BAQ) which varies by grade/rank. The allowance is increased if the Servicemember has dependents. Servicemembers also receive a variable housing allowance (VHA). Introduced in 1985, the VHA is determined geographically and is calculated based on annual surveys of what members in a locale actually pay for private sector housing, rather than on average local housing costs. The result has been overcompensation in low cost areas and undercompensation in some high cost locales. The VHA was intended to limit members' out-of-pocket housing cost to 15 percent of their housing costs, however, this percentage currently exceeds 20 percent. The services and OSD have agreed to a new formula for payment of a single allowance replacing the BAQ and VHA. Their plan would tie the single housing allowance to an appraisal of rental costs in each housing region. The proposal must still clear the White House Office of Management and Budget before being sent to Congress as part of the President's FY 1998 Defense Budget request.

Figure II. MILCON HOUSING PROGRAMS Congress has, over the years, approved a number of Military Construction (MILCON) programs to secure housing:

- Rental/Mortgage guarantees (Wherry/Capehart/line of credit). The Wherry (rental) housing program ran from about 1950 through 1955. Capehart (mortgage guarantee) housing started in 1955 as a government program to rapidly construct on-base housing. The Air Force purchased 277,000 units using this authority. The debt has been retired and most of the units are still in use.
- Sale of government land in return for housing. Under specific legislation, the government can sell a portion of a base in return for housing or cash. The authority has been used successfully but has limited application because the land must have special

value to the private sector to make it worthwhile.

The Military Construction Authorization Act of 1984 created two third-party financing authorities (Title 10 USC, Sections 2836 and 2837):

- Long term leases (section 801), build-to-lease authority. The Government contracts for housing to be privately financed and constructed, and then leased to a military service for period of 20 years. DoD has about 12,000 units completed or under construction using this authority.

- Rent guarantees (section 802). The government assures occupancy of private rental housing that is constructed by the private sector on or near an installation with a housing shortage. This authority has been used in Hawaii where the government has 268 units of rent-guaranteed housing.

While these methods are still available to the government, they are rarely considered today. They were drafted too narrowly, requiring project by project approval and funding, and no longer fit the current realities of scarce defense resources and mounting need.

Figure III. MIXED LINES OF AUTHORITY IN THE MILITARY HOUSING PROCESS

Within the Office of the Secretary of Defense, responsibility for housing issues belongs to both the Under Secretary of Defense for Personnel and Readiness and the Under Secretary of Defense for Acquisition and Technology. Housing policy resides with the former; procurement and renovation with the latter. Compensation issues fall under the jurisdiction of the Under Secretary of Defense, Comptroller. The Housing Revitalization Support Office, or HRSO, established by Secretary Perry to be a joint service project team, is organized under the Deputy Assistant Secretary of Defense (Installations) who is in the USD (A&T) chain of command.

Each Service has parallel organizations. Responsibility in the Army rests with the Assistant Secretary (Installations, Logistics and Environment), in the Navy with the Assistant Secretary (Installations and Environment), and in the Air Force, the Assistant Secretary (Manpower, Reserve Affairs, Installations and Environment).

On Capitol Hill, oversight is performed by specific subcommittees in both houses. On the House National Security Committee side, the Subcommittee on Military Installations and Facilities has cognizance over housing issues; the Subcommittee on Personnel governs pay and allowance issues. In the House Appropriations Committee, a similar division of responsibilities exists between the Subcommittee on Military Construction and the Subcommittee on National Security.

In the Senate, the Armed Services Committee also has two subcommittees with jurisdiction on housing issues. The Military Readiness and Defense Infrastructure Subcommittee rules on MILCON issues; the Force Requirements and Personnel Subcommittee decides compensation and benefit issues. The Senate Appropriations Committee is structured as in the House: separate subcommittees on Military Construction and Defense govern housing construction and O&M and compensation issues.

In the Executive Branch, major players are the Office of Management and Budget on compensation issues, the Internal Revenue Service on taxable status of housing allowances, and the Department of Housing and Urban Development which is responsible for establishing rent statistics on which portions of the VHA are based.

The woeful state of military housing presents both an obstacle to achieving quality of life goals and an opportunity for the Defense Department. According to military officials, the first challenge is to rejuvenate nearly 630,000 "unsuitable" units on or near 35 separate military installations. To put the problem in context, of the 300,000 military families who live on-base, 80 percent are in substandard housing due to size, amenities or repair. Of the 600,000 families who live in the private sector, 12 percent live in unsuitable housing, i.e., they pay too much, live too far from their place of duty, or are in unsafe areas or structures.¹

In 1994, Defense Secretary William Perry asked the Defense Science Board to examine issues related to retention of servicemembers. It established the Task Force on Quality of Life chaired by John Marsh, former secretary of the Army. On the housing issue, the task force concluded that much military housing failed to meet the Defense Department's goal of providing excellent housing facilities and services to all eligible military members, their families and eligible civilians.

The task force proposed a three stage solution to be implemented over three years. The first stage consisted of gaining Congressional approval of initiatives to attract private sector capital. The second stage recommended that the Department review and revise housing policies and regulations and improve ineffective and inefficient renovation plans. Perhaps their most aggressive recommendation was that the third stage implement the creation of a nonprofit government corporation called the Military Housing Authority.²

The proposal met with some resistance from the individual services. In addition, pay experts warned of dangerous tax consequences for the housing allowance structure which is currently treated as a non-taxable subsidy. For the present, creating such an authority is on the back burner while the Department seeks to implement the first stages of the task force's recommendations.

THE DEFENSE DEPARTMENT'S RESPONSE: HRSO AND THE "AUTHORITIES"

The Defense Department added \$2.7 billion to the six-year Future Years Defense Plan in 1995 for quality of life initiatives including quarters, housing maintenance and recapitalization. But, even as they did so, they recognized this funding level would be insufficient to solve the military's housing problem. Using the traditional military construction approach, it would take 30-40 years and nearly \$20 billion to renovate all unsuitable on-base housing units.

Congress, too, recognized the problem and provided new flexibility and the ability to reprogram \$1 billion toward new housing approaches in 1996. The authorities themselves are broad, allowing the Department to obtain private sector financing and expertise:

- **Guarantees.** DoD can guarantee mortgage payments, directly, or through an intermediary; or, provide limited guarantees against base realignment or closure (BRAC), force reductions, or major deployments. Additionally, the department can provide guarantees for mortgage insurance. Finally, DoD can guarantee rent and occupancy levels if necessary to secure private sector financing.
- **Leasing.** The Department may lease family housing units that have either been acquired or are newly contracted. A lease contract may include an operations and maintenance provision. The Department may also provide an interim lease. Finally, the Department may lease land.
- **Differential Lease Payments.** This authority allows the Department to pay the difference between negotiated rent and the BAQ/VHA to make housing available to service members.
- **Investments.** The Department may invest in non-governmental entities involved in the acquisition or construction of family housing and supporting facilities. Investments can be in the form of Limited Partnerships for which the Department provides cash, land, or facilities as equity. A limited partnership arrangement will operate purely as a private business. DoD will have no part in management. The Department may invest a maximum of one-third of the capital cost of a project. It also has the authority to convey land or buildings as part of its investment. In such cases, they may not exceed 45 percent of the

capital cost of the project. For projects involving renovation, replacement or support facilities, the Department's total equity contribution also may not exceed 45 percent of a project's capital cost.

- **Direct loans.** The Department may offer a direct loan. The title, land, and improvements remain with the developer.

The law also allows developers to build to local standards rather than to costly and time consuming military specifications. It contains five-year "sunset clause" meaning that if, after the fourth year the authorities have not become permanent law, the Department may not enter into any new contract five years after the February 1996 date of the Defense Authorization Act.

In October, 1995, in anticipation of enactment of the authorities, Secretary Perry established the joint Housing Revitalization Support Office, or HRSO.³ To get the program started, HRSO identified broad guidelines to give the private sector investors and developers a starting point. First, DoD wants to ensure that servicemembers and families are properly housed on- and off-base. Second, government funds must be leveraged with private capital. Third, local government must be involved from the start. Fourth, DoD wants to integrate projects with private sector housing and needs a mix of bedroom sizes. And fifth, housing projects must be in reasonable commuting distance of military installations.

The HRSO project solicitation and development process is still being refined. In general, it parallels the models used by state quasi-governmental housing authorities: individual military services nominate sites. A joint team from the Service, HRSO, and private sector experts evaluate the site to determine which of the new authorities to use and draft a Request for Proposal (RFP). The Service may then request qualifications from bidders and issue them an RFP. After the RFP is released, a pre-proposal conference may be organized to meet with developers and financiers. The Service then evaluates proposals and selects a developer. The process should take no more than 7-9 months to reach contract award. Construction should take an additional 12 months, bringing the total time line of the housing development process to approximately 21 months.

Ideal HRSO Project Development Process

Initial Site Review

Services Nominate

HRSO Collects Data and Develops Costs

Model Development Costs

Local Visit/FONT>

Design a Privatization Approach

Development Concept

Proforma

Solicitation Development

Develop Project Schedule and Draft RFP

Compete Business

Issue RFP

Conduct Industry Forum

Notify Qualified Field

Receive Proposals

Select Partner

Construct Specific Agreements

PROCESS-----7-9 Months: Construction /CONSTRUCTION-----12 Months

As 1996 drew to a close, HRSO had initiated 6 projects. Navy programs led off with Corpus Christi, Ingleside, Texas, (see accompanying mini-case study) and Everett, Washington. Nearing proposal stage were projects at Lackland AFB, Texas, Fort Carson in Colorado, Camp Pendleton in California, and Albany Marine Corps Logistics Base in Georgia.

CASE STUDY WITHIN A CASE STUDY: CORPUS CHRISTI, TEXAS

There is a sea change underway in the military housing business. Consider the Corpus Christi/Ingleside, Texas, area. In early 1995, the Navy considered doing business there in a new way. Rather than acting as a government purchaser, they

wanted to stimulate the private sector to provide housing for military families with the Navy acting as a limited partner. The groundwork had already been laid. In the FY 1995 Defense Authorization Act, the Navy was given authority to enter into limited partnerships for the purpose of meeting the housing needs of its members at installations where there was a shortage of suitable housing. Within the funding levels appropriated for Navy housing construction, the Secretary of the Navy could become an equity partner by providing between 5 and 35 percent of new housing project development costs. Private developers would provide the remaining funding and hold title to the developed property, recouping their investment through rents from the steady stream of Navy families that would occupy the housing. At some point in the future, the Navy could elect to liquidate its share of the partnership.

A Navy Housing Investment Board was empaneled to select project candidates. They opted for a small project in an area of great housing need, where land values were relatively cheap (it was expected that the Navy would have to supply land as an inducement to potential investors). The Coastal Bend area of Texas seemed to fit the bill. Existing Navy housing was antiquated, and insufficient. Additionally, the demand was growing as Navy units from bases being closed elsewhere were relocating to Corpus Christi. The Housing Investment Board approved a Corpus Christi private sector housing initiative as well as a similar test in Everett, Washington.

Captain Don Morris, the Navy's Director of Housing at the Naval Facilities and Engineering Command (NAVFAC), saw the entire Corpus Christi project unfold. He recalls that over 400 firms and individuals responded to ads in national real estate publications and the Commerce Business Daily indicating the Navy was "seeking a limited partnership to develop the Corpus Christi project."

The Navy selected the Corpus Christi project because growth of Navy presence in the area created housing needs not being met by the private sector. An industry forum was held in May 1995 to accompany release of a draft Request for Proposal. In it, the Navy set forth brief guidelines on what they wanted: a 3 bedroom townhouse arrangement that would rent for approximately what a junior enlisted person receives in housing allowances. They asked industry to propose a plan that included 2 and 4 bedroom units. At the forum, industry asked for more specificity in the numbers and type of housing the Navy wanted. The Navy said it was willing to spend up to \$9.5 million as its 35 percent share of the partnership. Industry asked the Navy to commit to an exact \$9.5 million share.

The revised RFP which appeared in June 1995 offered greater detail on housing requirements and formally set the Navy's share at \$9.5 million. It specified a two-stage procurement: a pre-qualification phase followed by a narrowed field of development proposals. In July, 27 qualification statements were filed. The Navy screened the list to 7 bidders who were asked to submit development technical and price proposals by October 19, 1995.

Solicitation Development: N62467-95-R-0985

May 1995:

Advertise in media and Commerce Business Daily
Industry Forum
Draft RFP for comment

Compete Business

June 1995: Issue RFP

July 25, 1995: Pre-proposal Conference:

August 1995:

Clarifying amendments 001-003 issued
Statement of Qualifications due
Downselect from 27 to 7 proposals

October, 1995:

Amendments 004, 005 clarify Submission of Offers

October 19, 1995:

Steps 1 & 2: Technical and Price Proposals due

Select Partner

November 1995-January 1996:

Convene Source Selection Board
Selection of Offeror: downselect from 2 to 1

January-May 1996: Final Negotiation

June 12, 1996: Contract Awarded

July 12, 1996: Agreement Signed

The technical proposals were to be detailed enough for the Navy to discern the quality and durability of the proposed housing. The price proposals presented a challenge for the bidders and the Navy. Industry wanted to know what the Navy—as a limited partner—wanted as a return on its investment. The terms of the partnership were uncharted territory for both sides. The Navy, familiar with the Section 801 build-to-lease, 20 year term method, proposed a 10 year partnership. Private developers, on the other hand, preferred to get in and get out in the least time possible, eventually selling the properties to Navy families. The Navy was not interested. They preferred rentals only. In the end, the sides compromised on a 10-year partnership with an option to extend for 5 years.

Other questions arose. Did the Navy know that Davis-Bacon wage rates would drive up the labor costs by 40 percent? Yes, but that was the law. At any rate the Navy recognized that large national developers would be less effected by the wage rates and, given a long 10 year partnership arrangement, that was the type of developer the Navy was seeking anyway. Could the Navy provide land? It would prevent an artificial bidding war among developers hoping to include land options as part of their proposals. Unfortunately, the FY 1995 legislation did not grant the Navy authority to do this. Would the Navy guarantee occupancy? No, doing so would require up front budget commitments that would make the project unaffordable.

In October 1995, the Navy convened a Source Selection board divided into technical and financial panels. They narrowed the field to 2 and in January, 1996, selected the finalist. The government and the developer then set to work on the partnership agreement. Since the Developer was the general partner, it took the first cut. It was no small task. Even though the government was to take a limited role, the requirements of the Federal Acquisition regulations and DoD and Navy policies which could not be waived eventually made it easier for the Navy to construct the wording of the agreement. In June 1996 with both sides tougher on the terms of the partnership, Landmark Organization, Inc., of Austin, Texas was announced as the winner of an estimated \$29 million project to develop 302 units on a 40-acre site in Portland, Texas, in the Ingleside-Corpus Christi area; and 102 units in Kingsville. Congress was notified of the agreement June 12 and had 30 days to raise objections. There were none and the final contract went into effect in July, 1996. The contractor secured financing for its \$19.5 million portion of the partnership through the Federal Housing Administration. Ground breaking took place in early November with some units expected to be complete within 9 months.

A PRIVATE SECTOR BENCHMARK: THE NAVY FAMILY HOUSING TASK FORCE

Could approaches other than HRSO's be used to speed solution of the housing problem? In early 1996, Robert B. Pirie, Assistant Secretary of the Navy for Installations and Environment, accepted the offer of an informal private sector task force to look at specific ways the Navy could further leverage its limited budget for family and bachelor housing.⁴

In essence, the task force was to take a purely private sector approach to solving the Navy housing problem. One of the problems to be resolved was the disparity in government versus private sector costs. For example, estimates of what the Navy spends to provide on-base housing run as high as \$15,100 per unit in annual operations and maintenance costs. The private sector estimates its costs for a comparable dwelling at \$7,200. Construction costs show a marked difference as well. It costs the Department of Defense an average of \$169,000 to construct a 1,400 square foot house on-base. Excluding the cost of land, the same amount of money in the private sector would provide 2,100 square feet.

The task force spent most of summer 1996 with housing officials on the Navy staff and at the Naval Facilities Engineering Command (NAVFAC) isolating and analyzing data on Navy and Marine Corps families and single personnel. Although the raw numbers were available, the housing supply/demand data was not well understood. By working through the Navy/Marine Corps statistics the task force narrowed the "problem" from a total housing demand of 588,000 (family and single) units to a determination that 494,000 servicemembers were housed suitably, with 94,000 in "unsuitable" housing. A further breakdown showed that the real requirement was 25,000 bachelors and 43,000 families in Navy Housing units, and 26,000 families housed in the private sector. The task force also determined that although the Navy had a significant budget, staff, authorities and commitment to solving the problem, these would be insufficient to eliminate the backlog of unsuitable housing.

A major finding turned on the question of housing affordability to the servicemember. The task force found that the Navy (in fact, all of DoD) had over time become accustomed to housing expectations that were out of sync with the private sector. The housing allowance system reflected that view in its compensation levels as well. In the military housing is viewed as a "free" benefit. If on-base housing is not available, the servicemember is provided with an addition to basic pay in the form of BAQ/VHA to cover a major portion of the cost of living "on the economy."

The private sector approach places far more responsibility and accountability on the individual consumer to determine what is affordable. The market reacts by setting housing price levels at the demand rate. A private sector formula would take into account spousal income (which the military does not, even though 65 percent of spouses work outside the home). When the task force overlaid a private sector affordability formula⁵ on Regular Military Compensation it found that all but the lowest ranking enlisted personnel could afford private sector housing in the all but a very few high cost markets. It was estimated that only 5 percent of the 94,000 unit requirement could not be solved by adopting a private sector standard to the affordability issue. The problem could be managed by isolating the outlying problem areas and using a combination of compensation adjustments and the authorities to affect the Navy "purchaser's" access to the private sector market.

The Navy Family Housing Task Force recommendations emphasized a private sector approach:

- • Redefine Navy housing objective from rebuilding or fixing the existing stock to housing Navy personnel by making the Navy "consumers" of private sector housing.
- • Use the new authorities, as necessary, to prime conventional market mechanisms.
- • Gradually change to a "rent"-based system by increasing allowances for private housing on a market-to-market basis, charging fair market rent for Navy housing, and outsourcing property management to the private sector
- • Sell most Navy housing to specific capital market segments—single, multifamily, apartment complex or property management firms.
- • Limit Navy-owned housing to specific operational segments, such as recruit billets, temporary training or mobility areas, representational quarters, and extremely high-cost/low-availability markets (like Hawaii).

The task force's recommendations were well received in the Navy. While they still must build consensus within the other services and OSD, a "compensation" solution to the military's housing problems could be an even more "private sector" approach than is being tried by HRSO today.

HAS THE PENTAGON'S WAY OF DOING BUSINESS REALLY CHANGED?

The Department's plans and HRSO's efforts involve the private sector in solving DoD's housing crisis. But the private sector has always been part of the military housing process—either as landlord for those servicemembers living off-base or as contractor/developer for building housing tracts on-base. The question is, has DoD really adopted a private sector approach?

The private sector housing industry operates much differently than its military housing counterpart. For starters, private sector market data is far better. While the military services maintain excellent demographic data on their members, and know, in the aggregate, the budgeted operations, maintenance, and construction costs, and the housing allowance outlays, they have very little insight into the detailed costs of providing housing. The private sector rises or falls on net operating income, therefore private sector knowledge of the balance sheet—income (rents) minus operating expenses—is precise. The industry is also supported by government and trade association national statistical data that charts geographic trends and personal income distributions which help determine potential markets.

Cultures differ as well. The military housing system is geared to "formula" production. Product is driven by the construction approach, designs are governed by military specifications, and financing is tied to the annual defense budget appropriation for construction (MILCON) and operations and maintenance (O&M). The private sector focuses on the customer and the investor. Products are differentiated by home buyer/renter preferences and local market conditions. Markets are driven by demographic analysis, with designs determined by local preferences and industry comparables. Financing reflects risk and return on investment.

One criticism of the Pentagon's housing revitalization program thus far is that it is designed to fix the current housing renovation backlog, albeit using private rather than public funds. At the end of the program, the military will still be in the position of builder and owner of vast public housing projects. As a result, the Congressional Budget Office projects that the percentage of military families in the United States living in government housing will increase from 30 percent in 1990 to 35 percent in 1997. A better objective, some say, would be to set a goal to house military families in the private sector, and gradually get DoD out of the housing business except for basic or temporary training and mobility requirements, representational quarters, and exceptionally high-cost/low-availability markets.

HRSO's start-up has been slow, as the Corpus Christi mini-case study shows. Through October of 1996, HRSO and the Services made progress on just 4 projects: Corpus Christi, Texas and Everett, Washington have contracts in being for a total of just over 500 units, pre-RFP plans for Lackland AFB, Texas, for 420 units; and, final project specifications for 840 new and 1,826 revitalized units at Ft. Carson, Colorado. Marine Corps' projects at Camp Pendleton and Albany, Georgia, are still in the wings. In 1997, HRSO and the Services hope to have contracts in-place for nearly 4,000 total units, but progress-to-date has been slow.

Captain Don Morris, formerly the Navy's Chief of Housing at NAVFAC, thinks the Corpus Christi initiative went smoothly for the amount of new contractual territory being covered. HRSO was new and did not really play a role in this instance—though they will become more involved in future projects. Morris' hope is that HRSO will become a broker in an investor-broker relationship with the Services. The Services would get out of the bricks and mortar builder mode and into that of buyer—or more properly, investor. The change in mindset would then be complete.

HRSO, after a year in operation, is just beginning to turn the legislated authorities into usable tools. Corpus Christi may have been an expected rough start-up. It is not without its problems. There are some unresolved questions about the liability to the Federal government of using FHA financing for the developers contribution to the project. End-to-end, the Corpus Christi project has taken 15 months to execute—nearly twice the time HRSO envisions for similar projects. Finally, in the Corpus Christi case, and in Everett as well, the contracts were awarded to developers with no previous military construction ties.

Thus far, this study has focused on attempts by the Services and OSD to invite private sector solutions to military housing. For all the news that is good however, there remain vestiges of the way business has been done that have major impacts on the Pentagon's efforts. A major throwback is the military construction program itself—long a source of interest to Members of Congress seeking to direct federal funds to their home districts. For example, the 1997 military construction program contains \$9.9 billion in planned projects—\$1 billion more than the Pentagon requested. The construction authorization and appropriations bills add \$257 million to the Pentagon's original \$714 million request to build family housing or renovate units. The new plan is to build 1,042 new units and to renovate about 5,300 units in 1997. To be sure, some of the new construction will avail itself of the authorities and programs being developed by the Services and HRSO, but the majority of the planned construction and renovation is on the business-as-usual, government-as-builder-and-owner model.

A technical problem that affects the government's ability to engage the private sector in solving the housing problem is the artifice of OMB "scoring." Briefly, under rules of the 1990 Budget Enforcement Act, the Pentagon is required to score 100 percent of the net present value of any housing programs in the current funding year. Thus, for example, the Section 801 build-to-lease authority would require DoD to fund in one year the entire 20-year lease for any new houses. The new authorities are an attempt to develop mortgage or loan guarantees that could be scored at less than 100 percent, yet the basic scoring problem remains.

CHALLENGE TO THE DEFENSE DEPARTMENT: CHANGE THE TERMS OF THE DEBATE

The military services continue to press for quality of life improvements as the number one way to retain service personnel. At the end of his tenure, Secretary Perry judged that, of the housing initiatives started under his guidance, "they are not moving as fast as I had hoped, but they are moving faster than I expected." But are they the right moves?

The real issue is one of changing the culture of housing in the military. Private sector housing experts say that the Department has adopted a "How do you correct today's problem?" solution, when what is needed is a far broader "How do you house servicemembers and their families?" vision. For the military to emulate commercial housing practices, it will have to change its perspective from that of builder to broker. The servicemember will also need to change mindset to that of the civilian buyer or renter in the commercial marketplace.

Can the private sector provide affordable housing that meets suitability and safety objectives to the military? The research thus far indicates that all but a small segment of the military population can afford to rent or buy a private sector home. If confirmed, it would be further evidence that changing the goals of the revitalization program to favor private sector solutions can obviate the recourse to the "authorities" to only a small (say 10 percent) of the military housing market. The change would further free DoD from having to become a limited partner or leaseholder in the housing market.

More recently, some military commanders have advocated finding ways to incentivize servicemembers to buy homes in the private sector. Moving to private sector solutions has the added benefit of integrating the servicemember into the local community, thus strengthening the connection between soldier and citizenry. Home ownership remains a goal of most American families. For the servicemember it is a way to build equity, recognizing that all personnel eventually return to the private sector after completion of their military careers—most at a relatively young age.

The most widely advocated change would be to move to a true "rent-based" system.⁶ Giving every eligible servicemember a housing allowance makes them "consumers" rather than tenants, and encourages accountability and responsibility. It levels the playing field between the private market and military housing managers: both would have to compete for the servicemembers housing needs. For the Pentagon, it moves the housing issue into the privatization/ outsourcing arena which, in other areas of DoD operations, promises to return huge savings that can be used for other pressing defense needs.

Congress approved a 4.6 percent increase in the BAQ for FY 1997. Such an increase is designed to reduce the average out-of-pocket costs to 18.5 percent. The Pentagon's plan is to reduce, over time, the out-of-pocket expense to about 15 percent. The 1997 bill also includes a guarantee of a minimum housing allowance that would apply to about 100,000, mostly lower ranking, enlisted members. The new housing minimum is step one in a larger overhaul of housing allowances aimed at giving people enough money so that all military members can afford off-base housing of adequate quality in safe neighborhoods.⁷

Congress has indicated willingness to redesign the housing compensation system. Implemented gradually so that no one sees a reduction in allowances, compensation proposals that allow the servicemember rather than Congress to decide how much to spend on housing seem to make sense. A single allowance, based on locality and rank and tied to the fair market value of housing rather than what is currently being spent, as is done today, would move the compensation policy toward private sector standards.

Expectations of servicemembers and their families are undergoing change. With promise of better housing allowances and the attractive amenities and options the private sector housing industry can offer, military families will look off-base increasingly for their housing. DoD will continue its policy of relying on local communities for family housing, providing government housing only when the private sector cannot meet the demand.

However, even with a focus on compensation and private sector solutions, the Defense Department will have a major influence on how America's military are housed. Initiatives started during Secretary Perry's tenure and the authorities granted by Congress signal a shift from the military services as "builder and buyer" to the services as "broker and investor." The cultural change will take time to become established. As it does, HRSO and the service housing agencies need to develop "best contracting" practices based on those in the private sector. As the Navy discovered on the Corpus Christi project, executing the privatization plan was challenging and time-consuming. But for the Defense Department to become a world-class consumer of housing services, it has to shift responsibility—and accountability—to the servicemember and place greater reliance on the private sector housing industry to meet the military demand.

NOTES

1 Substandard housing is defined as one or a combination of the following: The unit does not meet contemporary code standards for electrical and/or mechanical systems, and/or for energy efficiency. The unit may be too small, and/or lack amenities. Or, the unit rent could be significantly above BAQ/VHA, or be located outside the military housing area.

2 The Military Housing Authority concept has precedent in the quasi-governmental housing agencies in 48 of the 50 states and has a military precedent in Australia's Defence Housing Authority. The proposed authority would build, maintain and operate all military housing, using mainly private resources but also some government funding. It would operate as a tax-exempt, non-profit corporation returning all net surpluses to the corporation. Importantly, it would be exempt from federal procurement rules, military construction laws, and civil service requirements.

3 The Housing Revitalization Support Office is staffed with 13 full-time housing and real estate experts from the services and the Office of the Secretary of Defense (OSD). Consultants from the private sector augmented the office. HRSO's charter is to reinvent the way the Department provides housing and to test as many of the authorities as possible. Since its establishment it has developed a site data collection protocol and a financial feasibility model to evaluate housing proposals. About 40 potential sites have been listed and 14 have received formal evaluation. By the end of 1996 HRSO hoped to have 8-10 projects in place with up to 2,000 family housing units awarded. These projects will serve as prototypes to test the authorities. HRSO expects to cut the time it takes from site identification until new or renovated housing is ready to be occupied from 36-48 months currently down to 21 months.

4 The Task Force was chaired by Mahlon "Sandy" Apgar of Apgar & Co. in Baltimore. Membership included major private sector developers: Bill Murdy of General Investment and Development Company in Boston, Ron Terwilliger of Trammell Crow Residential in Atlanta, and Rod Heller of NHP Partners in Washington, DC. Messrs. Murdy and Apgar are BENS members. BENS provided staff and administrative support to

the effort.

5 Affordability baseline = base pay plus BAQ/VHA, tax advantages and other allowances multiplied by the industry standard 35 percent affordability index. (Spousal income was excluded.)

6 The Congressional Budget Office in its annual summary of deficit reducing options makes two proposals related to military housing policy.

The first is a recommendation that all military personnel eligible for family housing be given cash allowances regardless of whether they live in DoD or private sector units. Each family would be free to choose between DoD and private sector housing. DoD housing managers would set on-base rents at market-clearing levels. This system would force DoD managers to compete evenly with the private sector, retiring uneconomic units and renovating only those that could command rental fees sufficient to cover operating costs and amortized capital costs.

The second CBO proposal seeks to combine BAQ and VHA into a single housing allowance calculated based on estimates of housing prices in an area rather than on member's expenditures, as is being done currently. The problem, in brief, is that the current system adjusts for the changes in expenditures but not for the changes in benefits that housing price variations reflect. For example, people respond to differing house prices between locations by adjusting the expectations—more or fewer rooms, closer to or farther from work. Differences in housing expenditures between locations may not measure differences in housing prices or in well-being. CBO contends that the current system tends to undercompensate people in high-cost areas and overcompensate those in low-cost areas. Further, they contend that savings from reducing overcompensated areas would more than cover the costs of increased payments in high-cost areas.

7 The standards and costs to be used in computing the VHA minimum are set by the Department of Housing and Urban Development county-by-county survey of 2-bedroom, 1-1/2 bath apartments that meet health and safety standards. Any warranted increases to servicemembers would be provided by increases in the VHA.